

Productivity Commission inquiry into the 2018 GST distribution reforms

NSW Government final submission

6 October 2026

Acknowledgement of Country

We acknowledge that Aboriginal and Torres Strait Islander peoples are the First Peoples and Traditional Custodians of Australia, and the oldest continuing culture in human history.

We pay respect to Elders past and present, and commit to respecting the lands we walk on and the communities we walk with.

We celebrate the deep and enduring connection of Aboriginal and Torres Strait Islander peoples to Country, and acknowledge their continuing custodianship of the land, seas and sky.

We acknowledge the ongoing stewardship of Aboriginal and Torres Strait Islander peoples, and the important contribution they make to our communities and economies.

We reflect on the continuing impact of government policies and practices, and recognise our responsibility to work together with and for Aboriginal and Torres Strait Islander peoples, families and communities, towards improved economic, social and cultural outcomes.

Artwork:

Regeneration by Josie Rose | Gumbaynggirr Nation



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Executive summary

The New South Wales (NSW) Government welcomes the Productivity Commission's (PC) preliminary findings that the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (the 2018 legislative changes) are not working efficiently, effectively, or as intended.

The PC has also highlighted the significant cost of these arrangements to the Australian Government Budget. The inquiry into the 2018 distribution reforms (the inquiry) provides an important opportunity to restore confidence in the goods and services tax (GST) distribution system, and ensure that the GST distribution arrangements remain equitable, efficient and fiscally sustainable for all Australian governments.

The 2018 legislative changes are estimated to provide Western Australia (WA) with an additional \$28.6 billion in GST from 2018–19 to 2025–26. NSW considers that such an outcome is not consistent with achieving either equity or efficiency through a system of horizontal fiscal equalisation (HFE).

NSW supports the PC's definition of reasonable HFE as being 'the highest level of equalisation that can be maintained without creating material costs to efficiency, sustainability or certainty that cannot be addressed by other parts of the federation's policy toolkit' (PC 2026).

NSW strongly considers that GST distribution arrangements must be capable of adapting to changing state and territory (state) fiscal circumstances without creating permanent fiscal advantages for some states. Claims that states other than WA are no worse off financially compared with the previous arrangements represent a narrow fiscal interpretation of the temporary No Worse Off Guarantee.

NSW welcomes the PC's finding that NSW would have required an additional \$16.5 billion in 2024–25, in addition to the No Worse Off Guarantee, to be brought to the same fiscal capacity as WA. NSW Treasury analysis confirms this finding and finds that this amount remains high, at approximately \$16.1 billion in 2025–26 and \$17.0 billion in 2026–27.

All states other than WA are expected to be worse off when the No Worse Off Guarantee expires after 2029–30, as currently scheduled. Over time, these arrangements allow state governments with a greater assessed fiscal capacity than the standard state to invest more in the services and infrastructure that underpin opportunity, productivity and economic participation, and/or to offer lower taxes.

In this sense, the No Worse Off Guarantee protects against immediate financial losses, but it does not protect against the cumulative effects of unequal fiscal capacity and the loss of state fiscal competitiveness. The Australian Government's funding of these arrangements has also come at a significant opportunity cost, representing \$28.8 billion from 2018–19 to 2025–26.

A key conclusion emerging from the inquiry is that the standard state benchmark weakens equalisation, creates perverse outcomes and increases complexity. As the PC finds, the 2018 legislative changes 'create perverse outcomes that invert the logic of HFE' (PC 2026), enabling

states with stronger fiscal capacities than the standard state to receive additional GST payments when compared to the previous arrangements.

The PC concludes that the standard state benchmark 'should not be an ongoing feature of the GST distribution system' (PC 2026). NSW emphatically supports its removal as an essential component of future reform.

NSW's preferred position remains a population-driven distribution of GST, with Australian Government top-ups to fiscally weaker states to achieve reasonable HFE.

The interim report has highlighted the importance of addressing issues associated with the existence of a dominant state. The dominant state issue should be clearly defined, so that it can be addressed in a targeted way. NSW considers that the dominant state issue primarily relates to incentives to change tax and royalty rates, not incentives to expand a revenue base.

NSW proposes that the Commonwealth Grants Commission (CGC) develop a rules-based and time-limited approach to discounting revenue gains and losses arising from changes in tax and royalty rates by a dominant state. This would address the policy neutrality issue presented by the existence of a dominant state, while preserving equalisation in the long run.

The interim report also demonstrates the importance of ensuring that any future arrangements remain politically sustainable. Experience has shown that a system that permits extremely low relativities for extended periods can place significant pressure on public confidence in HFE.

Recognising the need to achieve national consensus, NSW supports moving to a modified version of full HFE with an Australian Government-funded relativity floor of 0.5, to protect all states from experiencing unsustainably low relativities. NSW considers that a relativity floor of 0.5 would have substantially reduced the pressure for the 2018 legislative changes, by avoiding the extreme GST outcomes experienced by WA.

NSW also considers that HFE reform should extend beyond the issues raised by the 2018 legislative changes. Accurate measurement of states' fiscal capacities is fundamental to achieving both equitable and policy neutral outcomes. NSW continues to support the incorporation of tax elasticity adjustments in the CGC's methods.

Given the equity implications of the lack of elasticity adjustments, the PC should recommend that the CGC introduce elasticity adjustments for relevant revenue assessments where material and practical, with consultation to occur through the CGC's 2030 Methodology Review.

1 Introduction

This submission is organised into six sections and one appendix.

Section 2 endorses the PC's preliminary findings that the 2018 legislative changes have reduced equalisation, increased complexity and can create perverse outcomes.

Section 3 argues that a population-driven distribution of GST would achieve the objectives of simplicity, practicality and transparency. Top-ups for fiscally weaker states funded by the Australian Government from outside the GST pool could achieve a reasonable level of HFE.

Section 4 recognises that WA's historically low relativeity was a key driver of the 2018 legislative changes, and that a policy solution is required for both a state being dominant in a category and a state having an unsustainably low relativeity.

To mitigate the disincentives for a dominant state to increase tax or royalty rates, NSW proposes the development of a rules-based and time-limited approach to discounting revenue gains and losses arising from changes in tax and royalty rates by a dominant state.

To protect all states from experiencing an extremely low relativeity, NSW also supports the restoration of pre-2018 arrangements with a 0.5 relativeity floor funded by the Australian Government from outside of the GST pool.

Section 5 argues that policy neutrality implications of the GST distribution are not confined to the mining assessment, and that elasticity effects should be considered in the CGC's methodology, where material and practicable, as they have both equity and efficiency implications.

Section 6 welcomes the PC's preliminary findings on the federal financial relations system and its interactions with the GST distribution.

Appendix A responds to the PC's preliminary findings and recommendations. It identifies where substantive NSW comments on these issues can be found within this submission.

2 Assessment of the 2018 legislative changes

NSW welcomes the PC's preliminary findings that the 2018 legislative changes are not operating efficiently, effectively, or as intended.

The 2018 legislative changes have reduced equalisation, introduced new, anomalous distributional outcomes, and imposed material fiscal costs without commensurate improvements in efficiency or revenue certainty.

NSW agrees with the PC's observation that limited public understanding of the GST distribution system in part contributed to the pressure for the 2018 legislative changes. The clear messaging and evidence-based analysis in the PC's interim report have made a strong contribution to informing public debate.

The 2018 legislative changes deliver a lower degree of equalisation

The PC finds that in 2024–25, WA's GST allocation enabled it to meet approximately 113 per cent of its assessed fiscal need, compared with approximately 98 per cent for other states, before No Worse Off Guarantee payments.

The PC estimates that NSW would have required an additional \$16.5 billion to be brought to the same assessed fiscal capacity as WA in 2024–25. This would have been equivalent to more than half of total NSW Government health expenditure in 2024–25 or around 90 per cent of total NSW Government transport expenditure in the same year (NSW Government 2025).¹

Furthermore, the PC finds that it would have cost the Australian Government approximately \$47 billion in 2024–25, in addition to the No Worse Off Guarantee, to bring all states to WA's fiscal capacity (from 100 per cent of assessed fiscal need to 113 per cent). To put this figure into context, it is equivalent to around 97 per cent of the total cost of the National Disability Insurance Scheme (NDIS) in 2024–25, the Australian Government's third largest expenditure program (Australian Government 2025).

This divergence has continued as the 2018 legislative changes have become fully operational. NSW Treasury analysis estimates the current arrangements will enable WA to meet 111 per cent of its assessed fiscal need in 2025–26 and 112 per cent in 2026–27.

¹ In 2024–25, total NSW Government health expenditure was \$31 billion and total NSW Government transport expenditure was \$18 billion (NSW Government 2025).

For NSW to reach WA's assessed fiscal capacity under the current arrangements, it is estimated to require an additional \$16.1 billion in 2025–26 and \$17.0 billion in 2026–27, in addition to the No Worse Off Guarantee.²

The cost to the Australian Government of bringing all states to WA's assessed fiscal capacity, in addition to the No Worse Off Guarantee, is estimated to be \$45.4 billion in 2025–26 and \$48.9 billion in 2026–27³.

The standard state benchmark can create perverse outcomes

The standard state benchmark links the GST allocation of a state with a greater fiscal capacity than the benchmark to the fiscally stronger of NSW or Victoria (Vic).

While NSW is the standard state, a deterioration in NSW's assessed fiscal capacity can increase the GST allocation of the fiscally strongest state, currently WA, notwithstanding that WA's own fiscal circumstances may not have weakened, and in fact may have strengthened, relative to the average of other states.

The PC illustrates this effect using a hypothetical \$100 million increase in NSW natural disaster expenditure. This increase could result in WA receiving an additional \$21 million GST, while other states, including NSW, would receive less, before No Worse Off payments (PC 2026).

Similar effects could arise from changes in NSW's assessed relative service delivery costs or revenue raising capacity. Box 1 includes other examples of perverse outcomes that can be created by the standard state benchmark. These examples illustrate that tying WA's relativity to that of NSW inevitably results in anomalous outcomes, inverting the logic of HFE.

Box 1: Perverse outcomes that can arise because of the standard state benchmark⁴

If the next Census finds there has been an increase in the distance Sydneysiders travel to work, relative to other capital cities, WA's GST share could increase. This would result from an increase in NSW's relative cost of delivering urban public services, weakening NSW's assessed fiscal strength.

If the number of NSW Veterans' Benefit Card holders increased, relative to other states, WA's GST share could increase. This would result from an increase in NSW's relative cost of delivering welfare services, weakening NSW's assessed fiscal strength.

² NSW Treasury calculations using the publicly available assessed budget and population data from the CGC's 2025 Update and 2026 Update.

³ As above.

⁴ While NSW is the standard state and WA is the fiscally strongest state.

Under the previous arrangements, the GST distribution provided a degree of protection against adverse changes in a state's fiscal capacity, with some delay due to the 2-year lag and 3-year averaging of data. For example, a decline in WA's capacity to raise revenue from mining royalties would, over time, be reflected in a higher relativity.

Under the current arrangements, however, WA's GST share is determined by the fiscal capacity of the standard state rather than its own fiscal circumstances. Consequently, changes in WA's revenue raising capacity have little bearing on the GST share it receives, while changes to the assessed fiscal capacity of the standard state are instead the primary driver of WA's GST share.

This is inconsistent with the fundamental principle that GST shares should reflect differences in states' relative fiscal capacities.

The 2018 legislative changes have cost the Australian Government considerably more than expected

The Australian Government initially projected the 2018 legislative changes to cost a cumulative total of around \$5 billion to 2024–25 (Australian Government 2018a, 2018b). However, the actual cost over this period was \$22.7 billion and the total cost between 2018–19 and 2025–26 is expected to have been \$28.8 billion.

The fiscal burden is also expected to continue, with the Australian Government currently forecasting the No Worse Off Guarantee to cost a further \$21.8 billion over the four years to 2029–30 (Australian Government 2026). This assumes that relativities will revert to historical averages as iron ore prices fall (Australian Government 2026). However, if iron ore prices remain at current levels, the cost of the No Worse Off Guarantee will be higher.

The 2018 legislative changes have transferred risk from WA's fiscal position by creating a material, volatile and open-ended Australian Government exposure whose value is influenced in large part by commodity prices.

As noted previously, the 2018 legislative changes delivered this risk sharing via an overcompensation in fiscal capacity that provides an inequitable advantage to residents of WA relative to other Australians. That exposure has an opportunity cost, because it reduces the fiscal capacity available for other Australian Government priorities.

The WA Government has introduced helpful analysis about the impact of resource prices on company income tax (CIT) receipts, which will have some offsetting impact on the cost of the current arrangements to the Australian Government while the No Worse Off Guarantee is in place.

The Australian Treasury is best placed to comment on attempts to quantify this impact, which will be complicated by crowding out of other business activities due to exchange rate and capacity effects.

Nonetheless, NSW rejects the assertion that the current arrangements have not come at a cost to the Australian Government. The proposition assumes an entitlement to a share of CIT revenue attributable to activity in a certain state. Such cyclical impacts on CIT receipts are a feature of all economic activities and not mining alone.

Finally, this will be of no benefit to the states that will bear the cost of the 2018 legislative changes from 2030–31.

The 2018 legislative changes provide fiscal benefits and certainty to WA only

The No Worse Off Guarantee ensures that no state receives less GST-related payments (GST entitlements and No Worse Off Guarantee payments) than they would have received under the previous arrangements, while WA receives substantially higher GST-related payments. However, from 2030–31, the first year after the No Worse Off Guarantee is due to expire, commodity price-related fiscal risk will shift from the Australian Government to all states other than the fiscally strongest state, creating significant uncertainty.

From 2027–28, the expiration of the No Worse Off Guarantee will enter state budgets for the 2030–31 fiscal year. A common theme across the budgets of all states in 2026–27, excluding WA, is concern with the fiscal cliff presented by the 2018 legislative changes and the expiration of the No Worse Off Guarantee.

- Vic notes that its 2025–26 No Worse Off payment is equivalent to the salaries of around 17,000 nurses, teachers, or police officers (Vic Government 2026).
- Queensland (Qld) warns it could lose up to \$1 billion annually after 2029–30, affecting the delivery of essential services and infrastructure (Qld Government 2026).
- South Australia (SA) describes its expiry as the ‘single largest threat’ to its budget metrics (SA Government 2026).
- Tasmania (Tas) notes that the finite nature of the No Worse Off Guarantee is a continued financial risk beyond 2029–30 (Tas Government 2026).
- The Northern Territory (NT) notes the risk to its revenue forecasts (NT Government 2026).
- The Australian Capital Territory (ACT) highlights ongoing pressure on fiscal sustainability (ACT Government 2026).

In 2026–27, the No Worse Off Guarantee is estimated to be worth \$2.1 billion to NSW. This is equivalent to supporting either:

- more than 39,000 victim-survivors and other clients who rely on flagship family and domestic violence crisis response services across NSW
- targeted assistance to more than 190,000 individual clients and 98,000 group clients through community and family support programs that provide early intensive support to address risk and vulnerability with families and children across NSW
- NSW's annual investment in out-of-home care services, supporting more than 20,000 of the most vulnerable and young children each year, including approximately 13,600 children living in out-of-home care
- around an additional 13,000 teachers in NSW public schools⁵
- around an additional 15,000 nurses in NSW public hospitals.⁶

Although NSW is temporarily protected by the No Worse Off Guarantee, the 2018 legislative changes represent a significant fiscal risk to NSW. The value of the No Worse Off Guarantee in 2026-27 demonstrates the scale of funding that would otherwise be unavailable to NSW. Once the No Worse Off Guarantee expires, any reduction in GST-related payments from 2030-31 will need to be absorbed through budget trade-offs, including reduced expenditure, additional revenue measures, or higher borrowing.

The 2018 legislative changes have provided direct support for WA's credit ratings and lowered the state's debt burden

The fiscal benefit to WA is also reflected in external assessments of its credit position.

- S&P Global has identified the 2018 legislative changes, together with strong commodity prices, as contributing to WA's strong fiscal outcomes and the restoration of its AAA credit rating in 2022 (S&P Global 2026).
- Moody's noted that the strong financial support provided by the Australian Government, in particular GST, is a key factor underpinning WA's credit strength (Moody's 2026).

⁵ This estimate does not represent the actual composition of the workforce. It assumes a 20 per cent on-cost and uses the full-time base salary of the highest grade (Step 7).

⁶ This estimate does not represent the actual composition of the workforce. It assumes a 20 per cent on-cost and uses the full-time base salary of a Registered Nurse at the highest grade (Level 8). This does not include salary-related allowances.

The 2018 legislative changes have increased the complexity of an already complex system

Complexity is an issue when it obscures who bears the costs of a reform and who benefits.

The previous arrangements, which included a 2-year data lag and 3-year averaging, were already complex. Introducing GST pool top-ups, a changing relativity floor and a standard state benchmark over a 6-year phased transition have greatly increased the complexity and opacity of the system.

This makes it more difficult to identify the distribution produced by HFE, the benefit conferred by the 2018 legislative changes and the government that ultimately bears the cost.

A more transparent design would first determine the GST distribution according to an explicit equalisation objective and then identify any supplementary Australian Government support. This would allow the fiscal cost and policy rationale of that support to be scrutinised directly.

3 NSW supports a population-driven distribution of GST

NSW supports a population-driven distribution of GST, as population is a major driver of state expenditure and infrastructure investment pressures. The costs of growth are often incurred up front, with rapidly growing centres such as Western Sydney creating significant investment pressures.

A more population-driven distribution would align GST revenue with these expenditure pressures and provide a distribution that is simple and predictable. It would also reduce policy neutrality concerns associated with the pre-2018 and current arrangements, including those arising from the dominant state effect (Section 4) and efficiency issues (Section 5).

NSW recognises that states have different revenue raising capacities and that equalisation remains an important feature of Australia's federation. Under the NSW proposal, GST would be distributed on a population basis. Additional support for fiscally weaker states would be provided transparently by the Australian Government from outside the GST pool to achieve reasonable equalisation.

The NSW economy is large, diverse and productive

The NSW population supports national labour supply, economic participation and growth

NSW's role as the largest Australian state by population has implications that extend beyond state borders. Sustained population growth increases demand for infrastructure, housing and public services, while also supporting national labour supply, economic participation and long-term growth. The scale and concentration of this growth are relevant contextual considerations when assessing how GST distribution arrangements interact with the costs of supporting nationally significant economic centres.

NSW is home to the largest population of any state in Australia. In 2025, there were 8.6 million people residing in NSW, representing around 31 per cent of the nation's population (ABS 2026b).

Since 2000, NSW has welcomed the largest share of net overseas migration, around 1.8 million people, the equivalent of 33 per cent of Australia's net overseas migration (ABS 2026b). Over the 20 years to 2020–21, around 89 per cent of permanent overseas migrants to NSW have chosen to settle in Greater Sydney (NSW Treasury 2026).

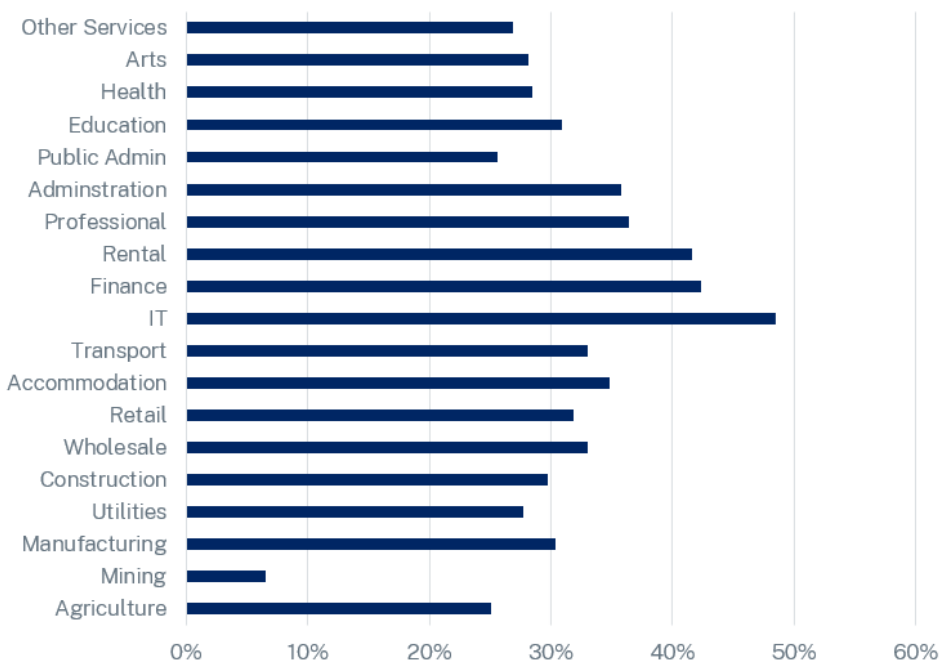
NSW accounts for a large share of national output and has sustained strong productivity growth

A productive and resilient NSW economy contributes significantly to national income, employment and investment. It supports economic activity across Australia through trade, investment and labour market linkages.

NSW is Australia’s largest state economy, with a gross state product (GSP) of \$855 billion in 2024–25 (ABS 2025). If NSW were a sovereign country, its economy would rank 32nd in the world, comparable in size to Norway and larger than the economies of Denmark, Colombia, New Zealand, and Finland (International Monetary Fund 2025).⁷

NSW’s economic activity is distributed across a broad range of industries (Chart 1), which makes it well placed to be resilient to a broad range of shocks and positions it to be an engine to drive further growth.

Chart 1: NSW share of Australian gross value added (GVA) by industry, 2024–25



Source: ABS (2025), Australian National Accounts: State Account

NSW’s sustained productivity performance and scale as a contributor to national output are relevant when considering the broader productivity and efficiency implications of alternative GST distribution arrangements.

NSW has achieved the strongest average annual multifactor productivity (MFP) growth of any state over the past 30 years, averaging 0.8 per cent per annum (ABS 2025). NSW also recorded average

⁷ NSW 2024–25 GSP converted using the average 2024–25 AUD–USD exchange rate and compared to 2025 GDP figures (nominal USD).

annual MFP growth of 0.6 per cent over both the past 20 and 10 years (ABS 2025). By comparison, WA's average annual MFP growth was 0.2 per cent over the past 20 years and effectively zero over the past 10 years (ABS 2025).

Sydney is key to Australia's competitiveness and growth

NSW's economic strength is underpinned by Sydney's role as a globally significant economic centre, which plays an important role in Australia's competitiveness and growth.

Sydney is Australia's largest financial capital, ranking 24th globally for hosting the headquarters of the world's largest public companies (Investment NSW 2026). Sydney is a global city with world-class finance, and innovation sectors. NSW is also home to one of Australia's fastest and largest growing regions, Western Sydney (Box 2).

Maintaining and developing the productivity and liveability of these centres requires sustained investment to accommodate population growth, support business activity and unlock future economic opportunities.

Box 2: Investing now in Western Sydney for future national economic benefits

Western Sydney is the third largest urban economy in Australia, with a gross regional product (GRP) of \$197.4 billion in 2024–25, larger than the GRP of the City of Brisbane (\$188.5 billion), the City of Melbourne (\$138.5 billion) and the City of Perth (\$61.7 billion) (Economy ID 2025a, 2025c, 2025d, 2025e).

The size of Western Sydney's economy is now larger than the economies of some states, including SA (\$150.0 billion), the ACT (\$55.6 billion), Tas (\$42.4 billion) and the NT (\$33.6 billion) in the same year (ABS, 2025).

Western Sydney is one of Australia's fastest growing regions. The annual growth of Western Sydney's GRP averaged 3.0 per cent from 2016 to 2025 (Centre for Western Sydney 2025) – higher than the average annual GRP growth of Greater Sydney of 2.2 per cent over the same time period (Economy ID 2025b, 2025e). This is broadly comparable with the average annual GRP growth over the same period for other major metropolitan economies, including the City of Brisbane (2.7 per percent) and the City of Melbourne (3.5 per percent) (Economy ID 2025a, 2025c).

There are 2.9 million people now residing in Western Sydney (NSW Government 2026) – just shy of the total population of WA of 3.1 million in the same period (ABS 2025).

The development of the Western Sydney International (Nancy-Bird Walton) Airport, the Western Sydney Aerotropolis and the Bradfield City Centre present a unique opportunity to create a globally connected economic hub that strengthens Australia's international competitiveness and productivity. These are expected to generate benefits that extend well beyond NSW, through higher productivity and employment.

Realising this potential requires substantial upfront investment by the NSW Government. These investments must often be made years in advance of the revenues and economic benefits they generate.

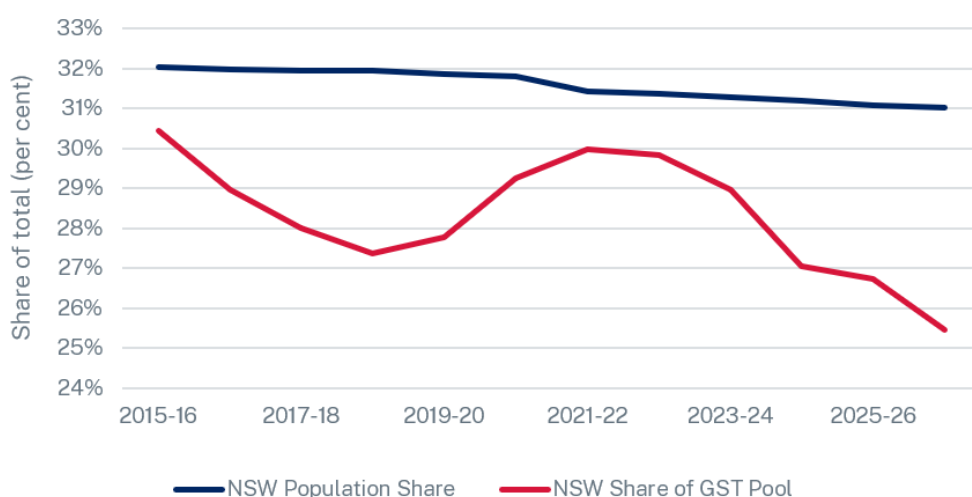
NSW considers that GST distribution arrangements should place greater weight on the expenditure pressures associated with supporting rapidly growing economic centres, such as Western Sydney.

The gap between NSW's population share and GST share has widened over time

The increasing gap between NSW's share of the national population and its share of GST entitlements illustrates the significant influence of fiscal capacity assessments on GST outcomes.

NSW's share of the national population is estimated to decline slightly between 2015–16 to 2026–27, from 32.0 per cent to 31.0 per cent (Chart 2). Over the same period, its share of the GST pool is estimated to fall much more sharply, from 30.4 per cent to 25.5 per cent. The divergence between NSW's relatively stable share of the national population and its materially declining share of GST entitlements is relevant context for assessing the outcomes of the GST distribution system.

Chart 2: NSW population share compared to GST pool share⁸



Source: Australian Government FBOs up to 2024-25 and Australian Government Budgets for 2025-26 and 2026-27

A population-driven distribution of GST with top-ups for fiscally weaker states would support a reasonable level of equalisation

A population-driven distribution, supplemented by transparent Australian Government top-ups for fiscally weaker state would provide a reasonable degree of equalisation while improving simplicity, transparency, and predictability.

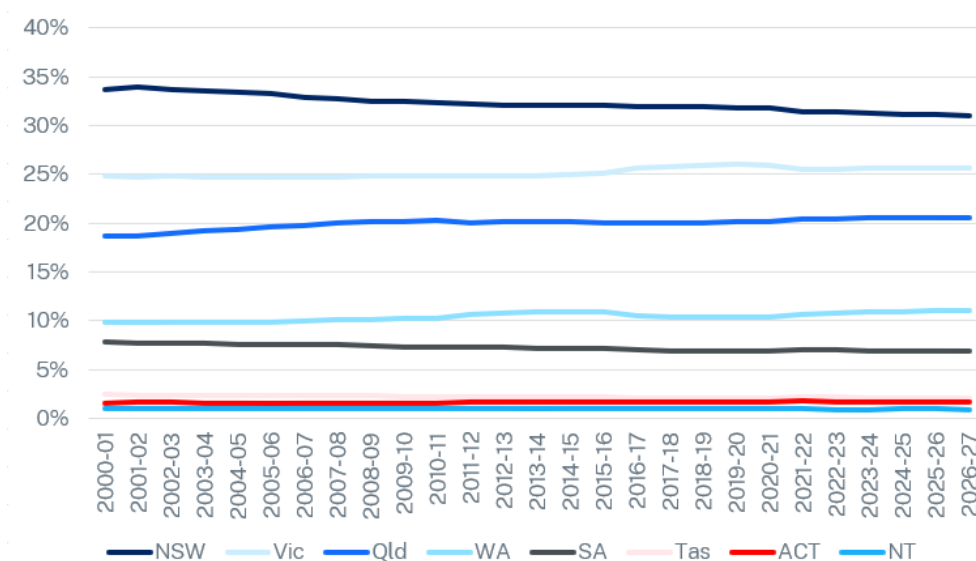
Distributing GST on a population basis would align funding more closely with the number of people requiring government services, while avoiding the complexity, volatility and technical disputes

⁸ NSW share of the GST pool excludes No Worse off Guarantee payments.

associated with detailed assessments of states' relative fiscal capacities. It would also provide greater certainty for long-term infrastructure and service planning and better support states required to invest ahead of future population growth and demand.

Volatility was a key factor that led to the 2018 legislative changes. Population shares change gradually (Chart 3). Unlike assessed fiscal capacity measures, a population-driven distribution would not be influenced by changes in commodity prices, methodological, or state policy decisions. This would produce a more stable and predictable allocation of GST.

Chart 3: State population shares



Source: FBO population figures used by the CGC to distribute GST. 2025–26 and 2026–27 population data obtained from the Australian Treasury.

A population-driven GST distribution would be more policy neutral and would avoid many of the incentive effects associated with the assessment of states' fiscal capacities. Further analysis on the dominant state effect can be found in Section 4. The efficiency of the pre-2018 and current arrangements are discussed in Section 5.

If this NSW proposal is not adopted, then the CGC should be encouraged to take account of these factors in its methodology reviews. The CGC's methodology reviews are primarily undertaken on an assessment-by-assessment basis, which may not fully capture the cumulative impacts of individual assessment methodology decisions.

The PC should recommend that the CGC undertake a top-down assessment of the cumulative impacts of its assessments as part of the upcoming 2030 Methodology Review.

4 The dominant state issue

NSW recognises that WA's historically low relativity was a key driver of the 2018 legislative changes. However, low relativities and dominant state incentives are related but distinct policy questions.

WA's low relativity reflected a substantial increase in its assessed fiscal capacity, driven by the concentration of iron ore production in WA and strong commodity prices.

The existence of a dominant state arises from the concentration of a large revenue base within a single state relative to its population share, with resulting effects on GST assessments and policy incentives.

A state may be dominant in a particular assessment category without experiencing an exceptionally low relativity, and a very low relativity may arise without a state being dominant in any assessment category.

NSW considers that the issues related to policy neutrality and extreme relativities should be addressed separately.

- Dominant state concerns related to policy neutrality should be addressed through targeted responses within the relevant CGC assessments.
- Concerns regarding very low relativities should be addressed through an appropriately calibrated relativity floor.

Definition of a dominant state

While a dominant state has not been formally defined by the CGC, it generally refers to a situation where a state is assessed to have a high share of the national revenue base relative to its population share. Dominant state effects can arise because the CGC measures states' revenue raising capacities by applying a national average royalty or tax rate to each state's assessed revenue base.

Where one state accounts for a large share of a revenue base, its own royalty or tax rate decisions can materially influence the national average rate used in the assessment. This can weaken incentives for a dominant state to increase royalty or tax rates, because a significant proportion of any additional assessed revenue is redistributed through the GST system.⁹

⁹ The converse also applies, as any reduction in royalty or tax rates is largely compensated for through higher GST revenues for a state.

NSW considers it is reasonable to define a dominant state as:

a situation where a state's share of a nominated revenue base exceeds its population share by more than 50 percentage points.

At this threshold, a state retains less than 50 per cent of the gross revenue generated by a policy decision related to that revenue base, all else being equal, giving rise to a material disincentive under the equalisation system.

For example, WA is dominant in the iron ore royalty assessment, accounting for approximately 98 per cent of the national iron ore royalty revenue base, while representing only around 11 per cent of Australia's population (CGC 2025).

If WA were to increase its iron ore royalty rate and this resulted in an additional \$100 million of assessed royalty revenue, its GST entitlement would be expected to decline by approximately \$88 million in the first full application year, all else being equal. WA would therefore retain only around \$12 million of the additional revenue generated by the royalty rate increase.

The dominant state effect primarily relates to the incentive to change a tax or royalty rate

WA has argued that the dominant state effect extends beyond tax and royalty rate-setting decisions to include decisions that expand the underlying revenue base. WA contends that the CGC's methodology discourages it from expanding its mining sector because a portion of the resulting increase in royalty revenue is offset through lower GST entitlements.

If approval of additional mining activity results in higher royalty revenue, a dominant state may retain only a relatively small share of the associated fiscal benefit, once GST effects are considered. In principle, this argument applies more broadly to any state seeking to expand economic activity, where growth in a state's revenue base increases its assessed revenue raising capacity.

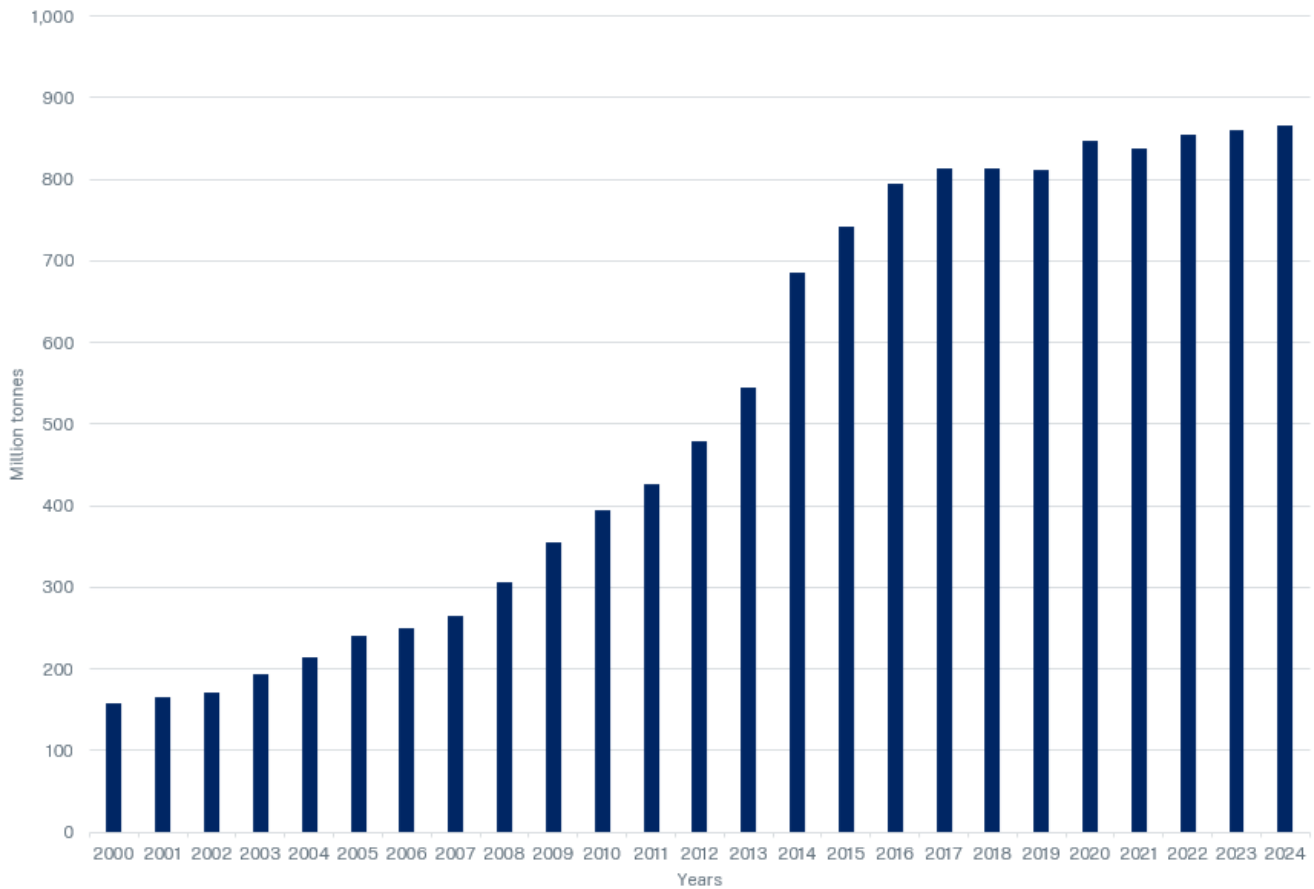
However, decisions to support resource development involve trade-offs that extend well beyond GST outcomes. State governments may pursue resource development to support employment, investment, regional development, exports and broader economic growth – even where a portion of the direct fiscal benefit arising through the tax system is redistributed through the GST system.

If HFE materially discouraged resource development by state governments, it would be reasonable to expect to observe persistent underinvestment in resource development by resource rich states.

Prior to the introduction of the 2018 legislative changes, the WA Government continued to promote mining investment, facilitate major resource projects and support the expansion of the resources sector. Over the same period, iron ore production in WA increased substantially (Chart 4).

While production decisions are primarily driven by private sector investment decisions and global market conditions, the available evidence does not suggest that the design of the GST distribution prior to 2018 was sufficient to prevent substantial expansion of WA's iron ore industry. Nor does the period following the phased introduction of the 2018 legislative changes provide clear evidence that access to more GST revenue from a higher relativity has materially altered industry outcomes.

Chart 4: Annual iron ore production in WA



Source: WA Department of Mines, Petroleum and Exploration (2026), Resources industry data

This suggests that the benefits of resource development, including higher economic activity, employment, investment and own-source revenue, remain strong incentives for state governments. While the design of the GST distribution system may influence incentives at the margin, it does not appear to have prevented resource rich states from pursuing major resource development opportunities.

Much of the dedicated mine-to-port infrastructure in WA's iron ore sector has historically been funded and owned by mining companies.

- Rio Tinto reports that in the Pilbara region it owns 18 mines, four independent port terminals and a rail network spanning nearly 2,000 km (Rio Tinto 2026).
- BHP and Fortescue similarly operate integrated mine, rail, and port supply chains in the Pilbara region, including more than 1,000 km and 760 km of rail infrastructure respectively (BHP 2023; Fortescue 2026).

Resource companies have therefore made substantial investments in the infrastructure directly supporting iron ore production and export activity.

NSW considers that the same principle applies to state decisions to expand other revenue bases, including facilitating the development of emerging industries such as critical minerals.

The CGC's methodology already captures mining revenue through the 'other minerals' category, which is flexible enough to adapt to new sources of mining revenues. Critical mineral deposits are also broadly distributed across states (Geoscience Australia 2024), reducing the likelihood of a dominant state emerging. However, if dominance were to arise for a particular critical mineral, a targeted and temporary adjustment could be adopted to address any resulting policy neutrality concerns.

Temporary discounting would help address the policy neutrality incentives of a dominant state in a targeted way

NSW proposes that the PC recommend that the CGC develop a rules-based and time-limited approach to discounting revenue gains and losses arising from changes in tax and royalty rates by a dominant state. This would help address the policy neutrality concerns presented by the existence of a dominant state while preserving equalisation in the long run.

As outlined in our initial submission, NSW supports the CGC adjusting its methodology to temporarily discount the additional revenue raised by a dominant state due to changes in tax or royalty rates. Revenue losses from tax and royalty rate reductions should also be discounted to help overcome the current incentive for a dominant state to reduce tax and royalty rates, where this is largely compensated for by higher GST revenues.

NSW considers this approach would significantly reduce any perceived policy incentives or disincentives for a dominant state. Under the NSW proposal, 100 per cent of any additional revenue from a policy change would be excluded from the CGC's calculations in the first year, with this percentage reducing by 20 percentage points in each subsequent year. After five years, the system would return to full HFE.

The required period and size of the discount for a dominant state are matters of policy judgement for the Australian Government. Both should be the minimum necessary to prevent anticipated GST feedback from materially weighing on the policy decision of a dominant state. A longer discount period would reduce the perceived disincentive, but would defer equalisation, coming at a greater cost to equity and increased implementation complexity.

Implementation considerations

NSW recognises that the introduction of a temporary dominant state adjustment would require detailed implementation design. While the final design would be a matter for the CGC, subject to approval by the Australian Government, NSW considers the following principles could guide implementation.

The CGC should establish a dominant state test – based on NSW's proposed definition or an alternative threshold determined through the methodology review process – and apply that test annually to each revenue assessment.

Once a state is identified as dominant within an assessment, the adjustment should apply only to future policy decisions regarding tax or royalty rates.

The temporary dominant state adjustment would not be triggered by changes in commodity prices, exchange rates, production volumes, mine approvals, exploration outcomes, or private sector investment decisions.

For eligible policy changes, revenue attributable to the decision would be estimated as the difference between actual revenue collected under the new regime and the revenue that would have been collected under the previous regime. This approach would isolate the fiscal effect of the policy decision from changes in underlying market conditions or production activity.

Where multiple royalty rate changes occur over time, each policy decision should generate its own adjustment stream and phase-in schedule. Once the adjustment period expires, all associated revenue should return to full assessment under HFE.

Finally, the operation of the temporary dominant state adjustment should be reviewed periodically as part of the CGC's methodology review process. This would allow the CGC to assess whether:

- dominance continues to exist
- the dominance threshold remains appropriate
- the duration and design of the phase-in mechanism continue to be justified, considering experience and evolving assessment methodologies.

Any changes to these parameters recommended by the CGC should be subject to approval by the Australian Government.

A permanent mining discount would reduce equity without addressing policy neutrality concerns in a targeted way

A permanent mining discount is not a targeted response to dominant state effects. It would apply to all mining revenues across all mining states, regardless of whether a state is dominant, thereby reducing equalisation.

WA, Qld and the NT have proposed a blanket mining discount to all mining revenues, not just those categories where the CGC assesses that dominance exists. This weakens the conceptual link between the proposed discount and the problem it is purported to solve.

More fundamentally, a permanent discount does not address the specific policy neutrality concern associated with a dominant state. A permanent discount would apply irrespective of whether any change to a royalty rate has occurred. It would therefore continue to provide GST advantages to mining states – even where royalty revenues were driven entirely by factors unrelated to government policy, such as higher commodity prices, increased production volumes, favourable exchange rates, or previously developed resource projects.

If the concern is that a dominant state's policy choices can affect the assessment benchmark, then relief should be targeted at those specific circumstances rather than applied to all mining revenues across all states.

If the problem is the risk of an extremely low relativity, NSW's proposed floor would provide insurance against this occurring (see below).

NSW views on PC proposals to address the dominant state issue

The PC presents various alternative approaches to addressing dominant state effects. NSW supports a temporary dominant state adjustment, as outlined previously, and considers that the merits of our proposal should be considered by the PC relative to the other options presented.

Comments on other options proposed by the PC are outlined in Table 1.

Table 1: NSW views on PC dominant state proposals

PC's alternative approaches	Definition	NSW's position	Supporting arguments
Dominant state mining discount	A mining discount applied only to commodities where a state has a dominant state effect, meaning it accounts for a disproportionately high share of that commodity's production.	Conditionally supportive	NSW supports a dominant state mining discount if temporary and targeted, as outlined previously.
Bundle of commodities approach	Instead of separately assessing revenue from iron ore, coal, gold and other minerals separately, commodities would be assessed as a group. This could reduce the weight of any one mineral that a state is otherwise dominant in.	Unsupportive	<p>NSW does not support a bundle of commodities approach.</p> <p>Aggregating various metals and minerals into a single category is appealing as it would dilute the influence of a state that dominates an individual resource base, improving policy neutrality.</p> <p>However, this would reduce the extent of equalisation in every year, not just when a dominant state changes its rate.</p> <p>A single all-mineral average rate would overstate the revenue capacity of states endowed with lower value minerals and understate the capacity of states with higher-value minerals.</p>

PC's alternative approaches	Definition	NSW's position	Supporting arguments
Sustainable income approach	This approach would assume that a state's mining royalties were paid into a notional sovereign wealth fund, and only the 'sustainable income' (the income that allows the fund to maintain its value) would contribute to the state's fiscal capacity assessment (Pincus 2011).	Supportive in principle	NSW supports the sustainable income approach in principle. However, estimating a sustainable income stream from resource assets is challenging in practice. An annuity approach requires estimating the underlying value of the resource stock, which depends on assumptions about reserves, future extraction rates, commodity prices, discount rates and asset life. Many of these inputs, particularly commodity prices, are highly uncertain and volatile.
Across-the-board mining discount	A mining discount reduces the proportion of state mining revenue used to assess a state's fiscal capacity. For example, a 25 per cent mining discount would mean that only 75 per cent of a state's mining revenue is counted in the CGC assessment.	Unsupportive	NSW does not support a permanent discount on mining, as outlined previously.
Hotelling rule-based discount	A mining discount that recognises that mining income is generated from the run-down of a non-renewable resource. That is, mining revenue would be assessed as net revenue, net of the rundown in the state's natural capital stock (El Serafy 1997).	Unsupportive	NSW does not support a Hotelling rule-based discount. The approach produces similar effect to depreciation by reducing the assessed value of resource revenues, which is similar to an ongoing mining discount.
Endowment-based approach	This would assess fiscal capacity based on states mineral endowments rather than production. Because resource endowments can be less concentrated than actual production, this may reduce dominant-state effects.	Unsupportive	NSW does not support an endowment-based approach as assessments should be based on what states do, not the value of underlying resource endowments that states could have explored.

PC's alternative approaches	Definition	NSW's position	Supporting arguments
Profitability-based approach	<p>This would assess fiscal capacity not from the royalties paid on mining activity, but on mining profits or economic rents.</p> <p>In some cases, this could reduce extreme outcomes where very high production does not translate into equally high underlying returns.</p>	Unsupportive	<p>NSW does not support a profitability-based approach.</p> <p>This would not reflect how states actually raise mining royalties, would likely increase the volatility of the mining assessment due to sensitivity to price and cost fluctuations, and is impractical due to the lack of available data.</p>

Commodity cycles and the need for durable equalisation arrangements

Australia has benefited from strong iron ore and coal export demand since the mid-2000s, driven by sustained industrialisation in Asia and production capacity established during the mining boom (Department of Foreign Affairs and Trade 2026).

However, over the long term, these conditions are unlikely to persist indefinitely. Demand for key commodities is expected to moderate as China's economic growth slows and industrialisation matures, while additional supply is expected from major producers such as Brazil and emerging suppliers in Africa (Department of Industry, Science and Resources 2026). Consistent with these trends, Australia's iron ore export earnings are forecast to decline over the period to 2030–31 as prices fall (Department of Industry, Science and Resources 2026).

Similar commodity cycles have occurred in other resource rich economies. For example, Chile's extended copper boom ended as Chinese demand growth slowed, and commodity prices weakened (International Monetary Fund, 2015). Chile addresses this volatility through a sovereign wealth fund that helps smooth fluctuations in mining-related revenues (Chilean Ministry of Finance, 2026).

In Australia, HFE performs a similar stabilisation function by adjusting GST relativities in response to changes in states' fiscal capacities.

A permanent mining revenue discount would weaken this mechanism by providing an enduring advantage to resource rich states irrespective of changes in underlying market conditions. As commodity markets evolve and mining revenues moderate, the discount would continue to shield mining revenue from equalisation, producing outcomes that become increasingly disconnected from relative fiscal capacity and contrary to the objectives of HFE.

A 0.5 relativity floor would protect all states from experiencing an unsustainably low relativity

To address the issue of relativity extremes, NSW has proposed the restoration of pre-2018 arrangements with a relativity floor of 0.5 funded by the Australian Government from outside the GST pool. This would ensure a defined, minimum GST distribution to protect any state from receiving an extremely low relativity, as experienced by WA.

All states would receive a full HFE share of the GST pool and any state with a relativity below 0.5 would receive a top-up funded by the Australian Government from outside the GST pool.

NSW considers that the proposed relativity floor is likely to be activated only in rare circumstances. It would therefore be less costly to the Australian Government than the current arrangements, which act more like a permanent subsidy than insurance.

It is important to note that the NSW proposed relativity floor would result in an increase in the fiscal capacity of any state that has a relativity that falls below 0.5. For example, if NSW proposed relativity floor had applied in 2026–27, the Australian Government-funded top-up to WA would enable it to meet 105 per cent of its assessed fiscal capacity (compared to 112 per cent under the current arrangements). Because the floor would be funded from outside the GST pool, all other states would receive a GST share based on full HFE, enabling them to meet 100 per cent of their assessed fiscal needs, unlike under current arrangements, where they achieve 98 per cent (before the No Worse Off Guarantee).

Chart 5: Assessed fiscal capacity achieved in 2026–27 under current arrangements, excluding the No Worse off Guarantee

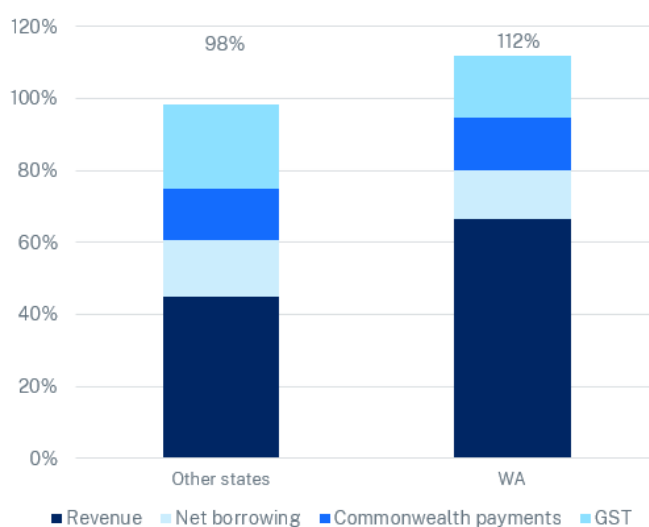
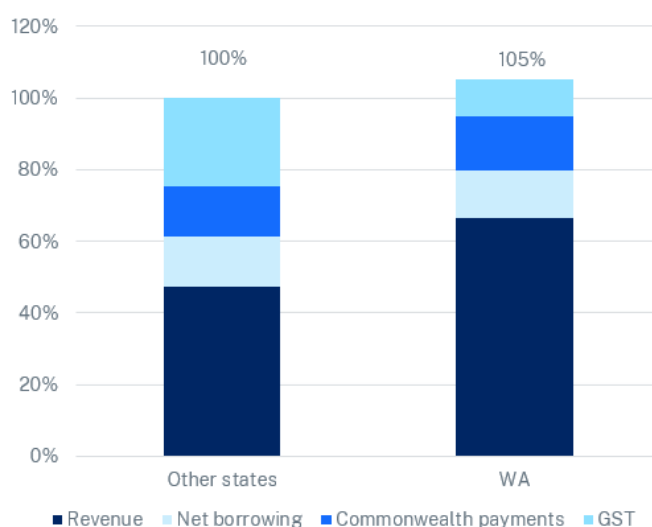


Chart 6: Assessed fiscal capacity achieved in 2026–27 with a 0.5 relativity floor funded by the Australian Government



Source: NSW Treasury calculations using the publicly available assessed budget and population data from the CGC's 2025 Update and 2026 Update.

NSW considers the introduction of a 0.5 relativity floor would provide a limited and targeted departure from equity in extreme circumstances, that would still be consistent with reasonable HFE. NSW considers that this modest departure from equity is justified to maintain broad-based support for a cornerstone of the Australian federation.

5 The efficiency of the GST distribution

A key objective of HFE should be to minimise distortions to state policy decisions.

While the PC has identified significant policy neutrality concerns in relation to the existence of a dominant state, it has shifted away from its 2018 view to conclude that such concerns are limited in other assessments.

NSW considers this conclusion may understate the potential effects of HFE on state revenue policy incentives for other CGC assessments, which depend on whether a state is assessed as having a revenue raising advantage or disadvantage and on the responsiveness of the relevant revenue base to changes.

These effects are not independent. GST distributional impacts and elasticities can interact, amplifying the divergence between the economic costs of reform borne by a state and the fiscal benefits it retains.

The policy neutrality implications of HFE should therefore be assessed with regard to both factors, rather than by reference to observed policy decisions alone.

Elasticities also have equity implications. Where behavioural responses reduce the revenue generated from a policy change, observed revenues may understate the underlying revenue base and assessed revenue raising capacity. This has the potential to affect the accuracy of some CGC revenue assessments and, therefore, the degree of equalisation achieved.

The GST distribution system can impact state revenue policy decisions beyond the mining assessment, with efficiency implications

The PC accepts that HFE can affect state revenue policy decisions, but concludes the effects are usually modest outside mining and are generally too small to be a primary determinant of reform.

The PC modelling puts the average effect under the current arrangements at around \$1.10 per \$100 of additional revenue raised by increasing tax rates, compared with \$10.60 for mining under the current arrangements (PC 2026). The PC requires the GST effect to be material relative to transition costs, distributional effects, political constraints and the direct costs of reform.

NSW considers that the relevant question is not whether GST consequences are the sole determinant of policy decisions, but whether they change the relative attractiveness of revenue policy options at the margin.

NSW agrees that HFE is unlikely to materially distort states' expenditure decisions but considers that it can distort revenue policy decisions, because states' shares of assessed revenue bases can diverge significantly more from their population shares.

NSW considers that, outside of mining, the potential for policy neutrality concerns is greatest for the land tax and stamp duty on conveyances assessments. This is confirmed by the PC's findings that NSW's GST share would fall by \$4.60 per \$100 of additional revenue raised by increasing land taxes, under the current arrangements (PC 2026).

NSW considers that GST consequences are a relevant consideration in state tax and royalty rate setting decisions. The challenge in identifying empirical evidence of these effects is that the strongest evidence may be a decision not taken. A state may choose not to pursue a particular revenue measure or may rely less on a particular revenue base, because a significant share of the resulting fiscal benefit would be redistributed through the GST system. Such decisions are inherently difficult to observe and quantify.

The absence of clear examples where governments have explicitly cited GST consequences as the sole reason for a policy decision should not be interpreted as evidence that GST impacts are irrelevant. As with many areas of public policy, decisions are informed by multiple considerations, and GST consequences are often one factor among them. NSW Treasury routinely advises the NSW Government on the likely GST implications of revenue policy decisions.

A key consideration for policymakers is to design the tax system in a way that raises revenue while minimising welfare costs – a principle known as tax efficiency. Understanding tax efficiency is relevant to long-term fiscal sustainability because the way revenue is raised impacts economic growth, which in turn affects long-term revenue raising capacity and spending needs.

HFE incentives vary across states and revenue bases

The PC examines the number of state tax changes recorded in NSW's interstate comparison of taxes publications before and after the 2018 legislative changes were introduced. It concludes that there is little evidence that GST consequences materially affect state revenue policy decisions outside the dominant state issue. It notes that many reforms proceeded despite adverse GST consequences and that WA did not increase mining royalties despite being largely insulated from GST effects.

NSW considers that this approach oversimplifies the incentive effects arising from HFE. The fiscal consequences of a policy change depend on whether a state is assessed as having a revenue raising advantage or disadvantage in the relevant assessment. As a result, similar policy changes can create materially different incentives across states.

To examine this issue, NSW reviewed major state revenue reforms over the past decade, taking into account states' assessed revenue raising advantages and disadvantages, and the likely GST consequences of policy changes.

The results suggest that the incentives created by HFE are not neutral across states but vary according to a state's assessed fiscal capacity in a particular revenue base.

Many policy decisions to increase revenue from a particular base were implemented by states assessed as having a revenue raising disadvantage in the relevant assessment, while revenue reductions were more common in states with a revenue raising advantage. This is consistent with the

proposition that the GST consequences of policy changes differ across states according to their assessed revenue raising capacity. HFE incentives may therefore not be neutral across states.

Tax elasticity adjustments should be integrated into the CGC's assessments where material and practical

The equity of the system of HFE relies on accurately measuring the revenue raising capacity of each state on a policy neutral basis. Where this does not occur, equity is compromised.

The imposition of a tax on a sector of the economy inevitably results in changes in the level of economic activity within that sector. Such changes may be small or large depending upon demand and supply elasticities. Where these changes are significant, differences in tax rates between states distort the accurate measurement of a state's tax base, with equity implications.

In addition to achieving equity, a fundamental feature of HFE is an attempt to achieve policy neutrality and therefore contribute to efficient economic outcomes. Under this approach, states should be able to achieve a more efficient revenue and expenditure policy mix without this materially impacting on the distribution of GST.

NSW does not consider that the entire GST distribution lacks policy neutrality, but rather that certain revenue assessments do not fully achieve policy neutrality because they assume state tax policy has no effect on the size of the assessed tax base.

Two revenue assessments where these impacts are particularly pronounced are stamp duty on property transactions and land tax.

Stamp duty

The CGC measures the stamp duty on property transactions tax base using the observed value of property transactions and does not account for the possibility that the design of taxes is affecting the number of transactions. This could be accounted for by including an estimate of tax elasticities. Analysis provided by NSW shows that tax elasticities are material for transfer taxes, i.e. the higher taxes in Vic do contribute to fewer transactions and an assessment by the CGC that Vic has a lower fiscal capacity. Applying an elasticity adjustment shows that the differences in the CGC assessment are material.

Table 2 highlights the significant difference in tax rates for property transfers between states. On average, Vic's tax rates on property transactions in 2024–25 were around 19 per cent higher than in NSW. Differences in tax rates are likely to have a significant impact on the current CGC measure of the revenue raising capacity of individual states for stamp duty on property transactions, with equity implications.

Table 2: Stamp duty on property transactions – selected CGC indicators for 2024–25

Indicator	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Share of assessed tax base	37.2%	23.7%	20.6%	10.5%	4.9%	1.2%	1.5%	0.4%
Population share	31.2%	25.6%	20.5%	11.0%	6.9%	2.1%	1.8%	1.0%
Revenue effort ¹⁰	98.3%	116.8%	90.0%	92.7%	98.4%	91.8%	66.7%	132.0%
Average tax rates compared with NSW	N/A	118.9%	91.6%	94.3%	101.1%	93.4%	67.9%	134.3%

Source: CGC 2026 Update Report

The absence of tax elasticity adjustments, which would account for the effect of tax rates on the tax base, undermines the achievement of equity.

The NSW Treasury submission to the CGC's 2025 Methodology Review quantified the impact on assessed stamp duty on property transactions revenue of applying an elasticity adjustment to the CGC's stamp duty assessment.¹¹

The results in Table 3 show that applying an elasticity adjustment to the CGC's stamp duty assessment generated material changes in assessed revenue capacity for most states, exceeding the CGC's materiality threshold in both 2021–22 and on a 5-year average basis.

¹⁰ Revenue effort measures the extent to which a state's tax rate is higher than the national average. Estimates above 100 per cent indicate that a state imposes a higher than average tax rate on the measured tax base.

¹¹ A typical estimate from the literature is that a 100 basis point increase in transfer duty reduces residential property transaction volumes by around 10 per cent. NSW Treasury adopted a slightly more conservative assumption of around 9.75 per cent after allowing for tax deductibility effects on non-residential transactions.

Table 3: Impact of adjusting for volume elasticity on assessed stamp duty on property transactions revenue (\$million)

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2017 – 18	-51.1	316.3	-216.8	-41.7	24.3	7.2	-38.9	0.8
2018 – 19	-54.7	321.3	-168.0	-24.3	-18.0	8.5	-33.2	-31.6
2019 – 20	-29.2	269.2	-187.1	21.9	-32.9	6.5	-43.1	-5.2
2020 – 21	-77.0	272.4	-215.5	15.3	37.2	19.4	-52.2	0.4
2021 – 22	-141.9	497.9	-257.5	2.2	-34.6	-6.5	-79.2	29.6
5-year average	-70.8	335.4	-209.0	-5.4	-4.9	7.2	-49.3	-3.3

Source: NSW Treasury submission to the CGC's 2025 Methodology Review

The lack of elasticity effects also has policy neutrality implications for the stamp duty on property transactions assessment. Under the current CGC methodology, Vic may also have an incentive to further increase transfer duty rates, as this would increase own source revenue while potentially increasing its GST entitlement through a reduction in its measured tax base.

If states' stamp duty tax bases were assessed on a more policy-neutral basis, including appropriate recognition of the impact of tax rates on transaction activity, this GST feedback effect would likely be reduced. This would improve policy neutrality by reducing the extent to which GST outcomes vary in response to state tax policy decisions and would better align incentives with economically efficient tax reform.

Land tax

NSW is also concerned that the absence of elasticity adjustments in the CGC's land tax assessment may affect the accuracy of assessed revenue raising capacities.

Economic theory suggests that land taxes are capitalised into land values. As a result, differences in land tax rates between states may influence measured land values and, consequently, assessments of relative revenue raising capacity.¹²

NSW Treasury raised this issue in its submission to the CGC's 2025 Methodology Review. Using 2021–22 data, NSW Treasury estimated that, for properties with a land value of \$5 million or more, NSW's assessed revenue was overstated by \$232.9 million, while Vic's was understated by \$159.1 million (NSW Treasury 2023).

¹² While differences in land tax rates are likely to have a relatively small effect on aggregate land values, given much land is exempt from tax, the effect is likely to be more material for higher-value properties that are generally subject to land tax.

These results suggest that the absence of elasticity adjustments may materially affect the CGC's assessments of states' relative revenue raising capacity and, therefore, the degree of equity achieved.

Implementation considerations

While NSW accepts that estimating elasticities is imperfect and uncertain, it is incorrect to assume an elasticity of zero.

Uncertainty exists in many aspects of current CGC methodology, but this should not be a deterrent to implementation. The CGC should make a conservative adjustment in the same way it does for other assessments. Through the 5-yearly methodology reviews, the CGC could refine the elasticity estimates in a similar way that assessment methodologies are updated.

The PC treats equity as the GST system's primary objective, with efficiency, sustainability and certainty operating as constraints. A departure from full HFE is justified only where distortions are material and cannot be better addressed through other tools.

Given the equity implications of the lack of elasticity adjustments, the PC should recommend that the CGC introduce elasticity adjustments for relevant revenue assessments where material and practical, with consultation to occur through the CGC's 2030 Methodology Review.

6 The Federal Financial Relations system

NSW welcomes the PC consideration of the broader federal financial relations framework and its interaction with the GST distribution system.

The inquiry provides an opportunity to consider reforms that improve the effectiveness of federal financial arrangements and strengthen the capacity of Australia's federation to support long-term economic growth, fiscal sustainability and service delivery.

Australia is a federation with power divided between federal, state and local governments. This distribution of power aligns with the principle of subsidiarity, whereby:

- the responsibility for functions should be with the level of government closest to the citizens it represents
- where matters affect multiple states or different rules result in high transaction costs, the responsibility should sit with the highest level of government.

In theory, this principle should foster an environment where governments can be autonomous, efficient and productive (Oates 1972; OECD 2022). A well-functioning federation requires a clear distinction of government responsibilities, fiscal and policy autonomy and a strong intergovernmental framework.

Vertical fiscal imbalance (VFI) occurs when there is a mismatch between the revenue raising power and spending responsibilities of different levels of government. While VFI is not uncommon in federations, the magnitude of fiscal imbalance in Australia is large in comparison to our Organisation for Economic Co-operation and Development peers (Organisation for Economic Co-operation and Development 2022).

The Australian Government raises around 81 per cent of tax revenue. States are responsible for almost half of all government operating expenditure but raise insufficient revenue to meet these expenditure requirements (ABS 2026c). The revenue raising capacity of states has eroded over time (NSW Treasury 2018), in part driven by High Court rulings.¹³

¹³ *Ha v New South Wales* [1997] HCA 34; *Vanderstock & Anor v the state of Victoria* [2023] HCA 30.

The broader federal financial relations framework reinforces the importance of GST as a stable and untied source of funding for states

Australia's high degree of VFI has resulted in states relying heavily on Australian Government transfers, including untied GST revenue and tied funding delivered through national agreements and Federation Funding Agreements (FFAs).

NSW Treasury has previously observed that the combination of significant VFI, overlapping service delivery responsibilities and increasingly prescriptive arrangements can weaken accountability and erode the principle of subsidiarity (NSW Treasury 2018). Over time, this can reduce states' flexibility to design and deliver services within their areas of responsibility and constrain fiscal and policy autonomy.

These challenges can be compounded where expenditure pressures and service delivery risks increasingly fall to states, without a commensurate increase in funding.

The implications of these arrangements can be seen in areas where expenditure growth is outpacing funding growth, resulting in a greater share of fiscal pressures being borne by states.

Box 3: National policy changes may create expenditure pressures that are not fully reflected in GST outcomes

In May 2026, the Australian Government introduced the NDIS Amendment (Securing the NDIS for Future Generations) Bill which is expected to remove several cohorts off the NDIS and reduce access to supports for remaining participants. To the extent that demand for services previously funded through the NDIS is redirected to mainstream service systems, states may face additional pressures in areas such as education, health and community services.

Because the effects of the NDIS reforms are expected to be broadly felt across all states, increases in assessed expenditure are likely to be reflected in the national average.

Consequently, any increase in service delivery costs that is broadly shared across states may not materially affect the distribution of GST. This means that a significant share of any additional expenditure burden would need to be managed within states' existing revenue sources.

Many of the challenges within Australia's federal financial relations framework are longstanding and systemic. These include:

- increasingly prescriptive funding arrangements
- uncertainty associated with short-term funding agreements
- growing administrative requirements
- misalignment of policy objectives between levels of government; in some cases.

These factors can affect the flexibility of governments to tailor service delivery to local needs. They can make long-term planning, investment and reform more challenging.

The structural drivers – including an ageing population, increased healthcare demand and growing service expectations – are projected to place ongoing pressure on government expenditure. The 2026–27 NSW Intergenerational Report (IGR) projects that expenditure growth will continue to outpace revenue growth over the next 40 years, creating an ongoing reliance on debt and increasing interest costs, absent to policy change (NSW Treasury 2026).

Strong institutional and governance arrangements are crucial for an effective federation

The Council on Federal Financial Relations’ role in Australia’s federal financial relations framework should be strengthened

The fiscal architecture of Australia’s federation is reflected in the operation of intergovernmental forums. The Council on Federal Financial Relations (CFFR) plays a critical role in facilitating collaboration between the Australian Government and the states on fiscal, economic and policy matters, including the oversight of intergovernmental funding agreements.

As the federal financial relations framework has evolved, opportunities have emerged to strengthen CFFR’s role in providing strategic leadership on fiscal issues. Clearer governance arrangements and more defined roles for treasurers in overseeing the financial relationship between governments could support more effective consideration of systemic challenges and long-term reform opportunities.

The CGC should continue to play a central role in the GST distribution system

Since its establishment in 1933, the CGC has played an important role in Australia’s federal financial relations framework by providing independent advice on the distribution of Australian Government funding based on HFE.¹⁴

NSW supports a GST distribution system that is transparent and provides appropriate opportunities for consultation. Given the technical nature of the CGC’s methodology reviews, state treasuries should continue to play a central role in the consultation process. State treasuries can consult with relevant government agencies to obtain the data and have the knowledge of state services to adequately inform positioning and evidence to the CGC.

A key challenge for states to forecast future relativities is not the data lags inherent in the HFE system. Instead, it is the CGC revising data from previous years without giving states prior notice. If states were given earlier advice on these changes, this will help states incorporate this and update their relativity forecasting models.

NSW considers the CGC well placed to provide indicative relativity forecasts given its access to comprehensive state data and its technical expertise. A centralised forecasting function could

¹⁴ Prior to the 1980s, the CGC made ad-hoc recommendations for top-up grants to selected states.

reduce duplication of effort across states and support a more consistent understanding of future GST outcomes.

NSW also considers the CGC well placed to monitor the operation and impacts of the GST distribution system on states' assessed fiscal capacities over time. This would complement the CGC's existing role in producing annual updates and provide governments with an independent assessment of how the system is performing over time.

The treatment of Australian Government payments should be transparent and consistent

The PC has accurately assessed that there are inconsistencies with how Australian Government payments are treated in the GST distribution process.

As a general principle, NSW considers that Australian Government payments should be included in the GST distribution unless there is a clear policy rationale – such as where a state is undertaking a function on behalf of the Australian Government or where funding relates to a project of national significance.

While the CGC has sought to improve transparency regarding the treatment of Australian Government payments, the rationale for quarantining some payments is not always readily apparent from the published framework. This can make it difficult to understand why similar payments may receive different treatment and may reduce transparency regarding the objectives being pursued through quarantining decisions. In addition to affecting the operation of HFE, quarantining decisions may influence the balance between tied and untied funding available to states.

NSW recognises that decisions regarding the treatment of Australian Government payments ultimately rest with the Australian Treasurer.

However, where payments are quarantined from the GST distribution process, NSW considers that the decision and its rationale should be clearly articulated through the terms of reference provided to the CGC.

Greater transparency would improve accountability and provide states with a clearer understanding of how Australian Government payment decisions interact with the GST distribution system.

Appendix A: NSW responses to the Productivity Commission's interim findings and recommendations

Interim finding 1.1

A lack of understanding of the HFE system has undermined the quality of public debate on the topic.

Agree. Limited public understanding of HFE and the GST distribution arrangements undermined the quality of public debate in the lead up to the introduction of the 2018 legislative changes.

NSW welcomes the PC's efforts to improve transparency and public understanding of the GST distribution. Greater transparency about who benefits, who bears the costs, and the degree of equalisation achieved would strengthen future policy discussions.

Further discussion of the complexity and transparency of the GST distribution system can be found in Section 2.

Interim finding 1.2

An unprecedentedly low relativity arising from the impacts of the mining boom, strained community acceptance of the HFE system in WA and was a catalyst for the 2018 reforms.

Agree. WA's historically low relativities contributed to pressure for the 2018 legislative changes.

Further discussion of WA's low relativity and its role in the 2018 legislative changes can be found in Section 4.

Interim finding 2.1

The new fiscal equalisation standard creates perverse outcomes that invert the logic of HFE, it should not be an ongoing feature of the GST distribution system.

Agree. The standard state benchmark has weakened equalisation and is counter to the logic of HFE. This benchmark should be removed, as pegging WA's relativity to the assessed fiscal circumstances of the fiscally stronger of NSW or Victoria introduces the potential for distorted outcomes.

If there are changes to the standard state's assessed fiscal position, this will result in changes to WA's GST share, even when WA's own assessed fiscal circumstances have not changed.

Further discussion of the perverse outcomes created by the standard state benchmark can be found in Section 2.

Interim finding 2.2

The 2018 reforms are not operating efficiently, effectively, or as intended.

Agree. NSW strongly supports the PC's preliminary findings that the 2018 legislative changes are more complex and less transparent.

The 2018 legislative changes have also reduced equalisation, introduced the possibility of perverse outcomes and imposed substantial costs on the Australian Government, without delivering commensurate improvements in efficiency or certainty.

Further discussion of NSW's assessment of the efficiency, effectiveness and operation of the 2018 legislative changes can be found in Section 2.

Interim finding 3.1

The GST pool boost has, so far, contributed to a divergence in fiscal capacities between the states and failed to meet its intent.

Agree. The GST pool boost was initially implemented to make all states better off. In practice, the total benefit has flowed to WA, increasing divergence in fiscal capacities while introducing an ongoing cost to the Australian Government, unlike the previous arrangements.

Further discussion of the GST pool boost can be found in Section 2.

Interim finding 3.2

The GST distribution system was and is broadly policy neutral, with some exceptions that are best managed through targeted responses.

Partially agree. NSW agrees that concerns regarding dominant state effects warrant targeted responses.

However, NSW does not agree that policy neutrality concerns are limited to mining revenue assessments. The GST distribution system can influence state revenue policy decisions across other revenue assessments, and the absence of elasticity adjustments can distort fiscal capacity assessments, with equity implications, and weaken reform incentives, with efficiency implications.

Elasticity adjustments should be therefore incorporated into the CGC's methodology for certain revenue assessments, where these have been shown to be material.

Further discussion of dominant state effects can be found in Section 4, and discussion of broader revenue policy incentives and elasticity adjustments can be found in Section 5.

Interim finding 4.1

The reduction in equalisation under the current system, with or without a permanent No Worse Off Guarantee has not markedly improved efficiency, fiscal sustainability, or certainty.

Agree. NSW considers that any theoretical efficiency benefits from the 2018 legislative changes are confined to WA, with no evidence that the 2018 legislative changes have altered WA's iron ore royalty policy settings.

Relative to the previous arrangements, the 2018 legislative changes impact the Australian Government's fiscal sustainability until 2029–30. From 2030–31, these costs are borne by all states except WA.

While the No Worse Off Guarantee remains in place, funding certainty for states other than WA is broadly unchanged, as they receive at least what they would have received under the previous arrangements. From 2030–31, the expiry of the No Worse Off Guarantee risks a fiscal cliff for all states except for WA.

Further discussion of the effects of the 2018 legislative changes on equalisation, fiscal sustainability and certainty can be found in Section 2, while their efficiency implications are discussed in Section 5.

Interim finding 4.2

Some alternatives perform better at lower cost to HFE than the 2018 reforms.

Agree. The three preliminary options presented by the PC are preferable to the current arrangements.

Any alternative arrangement which removes the standard state benchmark performs better against the objectives of equity, fiscal sustainability and transparency than the current arrangements.

Interim recommendation 4.1

Australia should return towards the pre-2018 system but the Australian Treasurer should direct the Commonwealth Grants Commission to address dominant state effects.

Partially support. NSW supports returning to the pre-2018 system with the introduction of a 0.5 relativity floor funded by the Australian Government from outside the GST pool.

To address dominant state effects, NSW supports the PC directing the CGC to develop a rules-based and time-limited approach to discounting revenue gains and losses arising from changes in tax and royalty rates by a dominant state.

This would address the policy neutrality issue presented by the existence of a dominant state, while preserving equalisation in the long run.

Further discussion of NSW's proposed temporary dominant state adjustment and 0.5 relativity floor can be found in Section 4.

Interim recommendation 4.2

If the Australian Government is not minded pursuing interim recommendation 4.1, Australia should return to a pre-2018 system and the Australian Government should make direct payments to states it considers are affected by dominant state issues.

Partially support. NSW supports returning to the pre-2018 system with the introduction of a 0.5 relativity floor funded by the Australian Government from outside the GST pool.

While state dominance is not a necessary condition for a historically low relativity, this approach would deliver an equivalent outcome while preserving the integrity of HFE and the principle of distributing GST based on relative fiscal capacity.

Further discussion of NSW's proposed Australian Government-funded 0.5 relativity floor can be found in Section 5.

Interim recommendation 4.3

If the Australian Government does not pursue interim recommendation 4.1 or 4.2, it should make the minimum changes to address the critical issues in the current system.

Partially support. NSW supports removing the standard state benchmark and Australian Government top-ups to the GST pool.

The benchmark produces outcomes that are inconsistent with the objectives of HFE, while the pool top-ups impose an ongoing fiscal cost on the Australian Government, which have so far only benefitted WA. However, NSW considers that a 0.75 relativity floor represents a significant departure from equalisation.

A 0.5 relativity floor funded by the Australian Government from outside the GST pool would provide a better balance between equity, fiscal sustainability and political durability.

Further discussion of NSW's concerns with the standard state benchmark can be found in Section 2, while NSW's proposed 0.5 relativity floor is discussed in Section 4.

Interim finding 5.1

The Commonwealth Grants Commission has adopted an independent, consultative and transparent approach to its role, but should strive for continuous improvement.

Agree. The CGC plays an important role in Australia's federal financial system delivering independent and transparent advice to the Australian Government. NSW recognises that the CGC maintains regular consultation with states and that its independence is an important feature of the GST distribution process.

There may be opportunities for the CGC to further strengthen engagement with states and continue to improve transparency around key methodological decisions and their implications for GST outcomes.

Given the highly technical nature of the GST distribution, state treasury submissions should remain a central focus of the methodology review process.

Further discussion of the role of the CGC can be found in Section 6.

Interim recommendation 5.1

Monitoring the potential for the HFE system to contribute to diverging state outcomes.

Support. The CGC currently assesses the relative fiscal capacities of states as part of its process for recommending GST relativities.

NSW considers that the Australian Treasurer should task the CGC with regularly publishing analysis of the aggregate impacts of the GST distribution system on states' fiscal capacities.

Further discussion is provided in Section 6.

Interim recommendation 5.2

There should be a more transparent approach for quarantining Australian Government payments.

Support. NSW recognises that decisions to quarantine Australian Government payments from the GST distribution process are a matter for the Australian Treasurer.

Where payments are quarantined, the rationale should be clearly articulated in the CGC's terms of reference, to promote transparency and certainty.

Further discussion of the treatment of quarantined Australian Government payments is provided in Section 6.

Interim recommendation 5.3

Ensure Federation Funding Agreement schedules provide net benefits for the community.

Support. FFAs should be negotiated in a manner that is consistent with the Federation Funding Principles endorsed by National Cabinet and CFFR in 2020.

Further discussion of FFAs and opportunities to improve their operation is provided in Section 6.

Interim recommendation 5.4

Update the Intergovernmental Agreement on Federal Financial Relations, its schedules, and the enabling legislation.

Support. The Intergovernmental Agreement on Federal Financial Relations and its supporting schedules should be periodically reviewed and updated in consultation with states to ensure the framework remains fit for purpose. This would improve clarity, accountability and decision making.

Further discussion of opportunities to strengthen the federal financial relations framework is provided in Section 6.

Interim recommendation 5.5

Improving the functioning of Council on Federal Financial Relations.

Support. CFFR should continue to serve as the principal intergovernmental forum for fiscal and economic matters. There may be opportunities for CFFR to play a stronger role in overseeing funding agreement negotiations and advancing strategic fiscal reform.

Further discussion of the role of CFFR is provided in Section 6.

Interim recommendation 5.6

Enhancing the Government Finance Statistics.

Support. NSW supports improvements to Government Finance Statistics to enhance transparency, comparability and understanding of fiscal outcomes across states.

NSW considers that CGC assessment data should, wherever practical, align with published ABS aggregates, with assessment adjustments applied separately where required. This would improve transparency, reduce the risk of data inconsistencies and support confidence in both datasets. NSW also supports a review of the quality and consistency of Classification of the Functions of Government expenditure data.

Interim recommendation 5.7

Improving governments' long-term fiscal sustainability reporting.

Support. NSW supports greater transparency regarding long-term fiscal sustainability risks.

Consistent with this objective, NSW has legislated the publication of intergenerational reports every five years.

Glossary

ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
CIT	Company Income Tax
CFFR	Council on Federal Financial Relations
CGC	Commonwealth Grants Commission
FFA	Federation Funding Agreement
GRP	Gross Regional Product
GSP	Gross State Product
GST	Goods and Service Tax
GVA	Gross Value Added
HFE	Horizontal Fiscal Equalisation
IGR	Intergenerational Report
MFP	Multifactor Productivity
NSW	New South Wales
NDIS	National Disability Insurance Scheme
NT	Northern Territory
PC	Productivity Commission
Qld	Queensland
SA	South Australia
Tas	Tasmania
Vic	Victoria
VFI	Vertical Fiscal Imbalance
WA	Western Australia

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